Fifth Third Bank

April 6, 2004

Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Ave. N.W
Washington, D.C. 20551
Docket No. R-1151

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RE: Docket No. R-1151 Amendments to the Community Reinvestment Act Regulations

Dear Secretary Johnson,

Let me take this opportunity to thank you and your colleagues for this opportunity to comment on the proposed amendments to the Community Reinvestment Act (CRA). We appreciate the investment of time and effort that the collective body of regulatory agencies has contributed to this process and hope that comments contained in this letter assists you in shaping an amended CRA product.

Primary changes proposed include redefining the definition of " Small Bank'; affecting public evaluation content and rating given any evidence of abusive lending practices; revising the format for CRA lending disclosure data and separately reporting originated and purchased loans in the public evaluation. Also in the proposal are various points that have no suggested change but does solicit input from the industry and consumers. In addition to proposed changes we are offering comment on investments measures and guidance that should be implemented for clarity in the Investment Test.

Our perspective on changes proposed for:

- The definition of "Small Bank" is that we concur with the size recalibration from $250 million to $500 million but do not agree with an elimination of holding company provisions. In maintaining the holding company component it should be raised to ***$3*** billion. Approaching the change in this manner provides the burden relief wanted while not creating a loophole that leads to disparity in treatment.
- Public evaluation content and rating recommendations, given any evidence of abusive lending practices, should not be approved as written. As written a mandatory downgrade of a banks CRA rating must occur even when a minor infraction of any lending regulation is involved. No consideration for the number of occurrences, lenders intent or statistical significance is considered in the process. We agree that there must be strong remedies to discourage unfair lending practices, but the current proposal does not differentiate between limited error and widespread affect. Because of the magnitude of risk many reputable banks may choose not to devise or offer credit products to impaired credit customers. Often these products are slightly more complex in character to offset the additional credit risk assumed

- CRA lending disclosure is that it increases reporting consistency with HMDA loan disclosures formats and should be approved.
- Distinguishing loan purchases from loan originations in public evaluations has no meaningful purpose and should not be adopted. The unintended message regulatory agencies are sending, is that loan originations are preferred to loan purchases even though no formal weighting difference exists as yet. Sending such as message could result in less liquidity for purchasing loan products in the market place.

Proposed Revision of Small Bank Definition

Collectively the agencies' are proposing to amend the definition of "Small Institution" to mean an institution with total assets of less than $500 million, without regard to any holding company assets."

Comment to Pronosal

Changing the threshold for defining a Small Bank, as stated in the pending notice of proposed rulemaking, is one of the most pragmatic of the amendments considered. The elevation of the threshold to a $500 million amount is a better representation of the compatibility of size and resources available for addressing Large Bank requirements under the Community Reinvestment Act. However, holding company provisions should not be eliminated but raised to a minimum of $3 billion.

We agree that the asset size increase from *$250* to $500 million, appropriately takes into account the substantial growth of institutional assets and consolidation in the banking and thrift industries since the 1995 CRA overhaul. Clearly the demands of CRA require additional resources to be utilized for success under the Large Bank Test as compared to the Small Bank Test. These additional resources involve, equipment, processes and personnel costs that are proportionately higher and materially more significant for a small institution. Because of these realities the Small Bank definition should be modified to recognize shifts in the asset size of financial institutions to achieve the less burdensome intent envisioned.

However, there should be no elimination of holding company provisions as a part of the Small Bank definition, although it should also be increased to better reflect industry changes. Instead of the holding company asset provision of $1 billion, consideration should be given to raising this portion of the definition to $3 billion. This is a continuation of the same arguments that exist for changing the individual Small Bank asset requirement. Maintaining the holding company provision also insures that a large holding company comprised of small banks, operates in a manner that sufficiently addresses community credit needs.

Independent banks that form a holding company often do so for multiple purposes, chief amongst them is the acquisition and ownership of financial institutions beyond its area of origination. Given this fact the question must be asked; should a collection of small banks that comprise a large holding company, be given a blanket exemption for how their CRA performance is measured? My response to this is no, and I am sure that the intent is not to provide a significant loophole of lower accountability for financial institution growing strategically in that way. Any bank looking to have only a Small Bank burden will make every effort to grow using a modified "Unit Bank" approach with no one charter exceeding $500 million.

Proeosed Expanded Comment in Public Evaluations

Collectively the agencies are proposing to amend regulations to specifically address abusive lending practices in CRA evaluations. Evidence that an institution has discriminated, utilized illegal or abusive credit practices in connection with loans will result in adverse affect to the institutions CRA performance. This would apply to both the institution and any subsidiary that has loans described by ***228.22*** (c).

Comment to Proeosal

Discussion of Fair Lending violations and other compliance regulations that have impact upon the consumer has, in my understanding, always been fair game for comment in a banks' Public Evaluation by regulators. In addition, it has also been practice that conclusive information pertaining to Fair Lending and other regulatory infractions, such as substantial resistible violations of Regulation **Z,** could result in an overall rating downgrade for the applicable bank. The extent of action taken has been chiefly delegated to the examiner/regulatory agency's discretion. Collectively, this has resulted in the most reasonable and fair manner for addressing these issues with benefit for consumers and to a lesser extent for banks.

Any financial institution using unfair practices, with the intent of discrimination, deserves all sanctions available in remedy for their actions. In addition, the same sentiments hold true for any financial institution that purposely gouges the public with predatory lending practices. However, the majority of violations that do occur are attributed to reputable banks making inadvertent errors and without malicious intent. The incentive for providing innovative or flexible credit is reduced given the blanket treatment of violations regardless of their magnitude or intent.

The mandatory rating downgrade for CRA could be counterproductive given the ridged and all encompassing scope proposed as a part of the revision. **As** proposed any error within the realm expressly mentioned, as well as any that is not expressly mentioned, would result in a downgrade and expanded comment. In the occurrence of a limit number of non-discriminatory compliance violations, there is an implied requirement for negative CRA impact that may distort bank performance without benefit to consumers.

An example is the use of a variable rate loan program in which an individual can eventually procure a fixed rate loan, from the same bank, upon remedying credit/underwriting shortfalls that may have existed at inception. These programs provide a fair financing source for credit-impaired individuals that potentially would not have a financing option. **As** proposed, a reputable bank would be adding considerable regulatory risk to a situation having greater than normal credit risk. Because any minor and limited number of violations involving Truth-In-Lending could result in both restitution and a CRA rating downgrade, risk may outweigh benefit for the bank. No matter how limited of an affect from the error, a reputable bank is treated with the same draconian punishment as a predatory bank.

Even more disturbing is the accompanying footnote to this section defining as an abusive lending practice any program that is based on other than the borrowers repayment ability. This could mean any bank that utilizes a no income streamline re-finance program, could unknowingly be using a credit practice deemed as abusive. In this scenario the bank is underwriting based upon a known relationship with customers to provide an inexpensive and expedient reduction in the loan rate. At face value the new provisions would label this as an abusive credit practice requiring a downgrade and negative public evaluation comment.

Proposed Change in Disclosure Compilation

As we know them to exist, changes to CRA loan disclosure information would read as:

(h) CRA Disclosure Statement. The Board prepares annually for each bank that reports data pursuant to this section a CRA disclosure statement that contains, on a state-by-state basis:

(1) For each county (and for each assessment area smaller than a county) with a population of 500,000 persons or fewer in which the bank reported a small business or small farm loan:

(i) The number and amount of small and small farm loans reported as originated or purchased by geography, grouped according to whether the geography is low-, moderate-, middle-, or upper-income;

(ii) **A** list showing each geography in which the bank reported a small business or small farm loan; and

(iii) The number and amount of small business and to business and farms with gross revenues of $1 million or less;

(2) For each county (and for each assessment area smaller than a county) with a population in excess of 500,000 persons in which the bank reported a small farm loan:

(i) The number and amount of small business and farm loans reported as originated or purchased in each geography, grouped according to median income of the geography relative to the area median income, as follows: less than 10 percent, 10 or more but less than 20 percent, 20 or more but less than 30 percent, **30** or more but less than 40 percent, 40 or more but less than 50 percent, 50 or more but less than 60 percent, 60 or more but less than 70 percent, 70 or more but less than 80 percent, 80 or more but less than 90 percent, 90 or more but less than 100 percent, 100 or more but less than 110 percent, 110 or more but less than 120 percent, and 120 percent or more;

(ii) A list showing each geography in which the bank reported small business or small farm loan; and

(iii) The number and amount of small business and small farm loans to business and farms with gross annual revenue of $1 million or less;

(3) The number and amount of small business and small farm loans located inside each assessment area reported by the bank and the number and amount of small business and small farm loans located outside assessment areas reported by the bank; and

(4) The number and amount of community development loans reported as originated or purchased.

Comment to Proposal

We concur with changes recommended for the format in which CRA loan disclosure information is presented. The change will allow a much closer comparison to the **HMDA** disclosure format.

Proposed Loan Purchase Discussion in Evaluations

To improve transparency in CRA evaluations the agencies propose to distinguish loan purchases from loan originations in the public evaluation's display of loan data, where pertinent. Loan purchases and loan originations would not be weighed unequally in the consideration of ratings for the Lending Test or the bank's overall CRA rating

Comment to Proposal

The segregation of originated loans from purchased loans in CRA evaluations does not have a useful purpose and should not be implemented. Even though the proposal states no difference will be made in the weighing of loan purchases or loan originations the fact that information is presented this way in the evaluation implies preference of loan originations over loan purchases. In addition, because this additional presentation is not a component for evaluation by examiners or mandated by regulation its inclusion only leads to consumer hypothesis of institutions integrity in meeting CRA. Whether intended or not regulator action in this manner sends a message that one method is preferred to another in serving an assessment area.

Clearly HMDA disclosures already identify originated from purchased loans and we concur with recommendations for implementation of this same reporting consistency for CRA lending disclosures. Making this information a display in evaluations is not necessary and has no stated relevance. However, if this is the beginning of regulator discouragement for loan purchases, this should be codified and prohibited as a part of regulatory law and not part of an appeasing soft sell.

Investment Test Discussion

As presented the discussion points for Investments are: 1) Is the Examiner weighting of investments on the books since the previous examination period sufficient. ***2)*** Should there be consideration for investments outside assessment areas to promote more efficient allocation of community development capital? **3)** Should the "innovative and complex" criterion be eliminated or made subservient to responsiveness as criteria. 4) How much is enough in the way of investments and what benchmarks should exist.

Comment to Investment Test Discussion

We feel that the Investment Test is an important part of the intent of CRA because it has a place in supporting low- and moderate-income neighborhood development. In the evaluation of a banks' CRA eligible investments the agencies have allowed reasonable qualifying instruments or activities for attaining the desired goal. Qualifying investments are considered from targeted grants, securities, investment funds and tax-credit purchases that provide financing to low-and moderate-income communities. To effectively meet the Investment Test there is a need to include in investment strategies some passive investments such as Mortgage Backed Securities. Much of my discussion will infer marketable type instruments but the concept would apply for a substantial number of other investments normally made by a bank for CRA purposes.

At the center of any discussion should be establishing targets of sufficiency for investments under the Investment Test. The amount of investments that should be made by a bank is one of the most misunderstood components of the examination process. As a result, the industry has been left to grapple with devising individual bench marks they feel will result in a reasonable rating and has not been conducive to a banks comprehensive strategy. In our opinion solving these variables will result in a better assessment of banks under the Investment Test while low- and moderate-income communities continue to benefit.

The most conventional strategies for banks have been to approach the level of investments as **a** percentage of tier one capital or as a percentage of assets. In using tier one capital, as a guide conventional wisdom is that a sufficient amount of investment is between three percent and five percent of tier one capital. This is a measure that had initially surfaced as an unacceptable

part of the request for comment leading to the 1995 overhaul of **CRA. As** a percentage of assets, the newer of the two measures, the range is between sixty-five basis points and one hundred basis points of total assets for a bank. The asset measure comes from a survey of median investments in comparison to total assets for financial institutions that have performed at outstanding and satisfactory levels for the CRA Investment Test.

Outside of having a variety of investment choices banks can make for investments the industry is hampered by the lack of flexibility for managing the timing of the investment portfolio for CRA purposes. The investment must be new, reviewed for the first time during the current examination, to receive the majority of benefit. Maintaining an investment for inclusion in a subsequent examination usually results in marginal credit. The end result is that in obscure markets there is an extensive cost that results from obtaining sufficient levels of investments that may not be readily available. These costs, in the least expensive scenario, originate from premiums spent to obtain sufficient securities and the deterioration that occurs as a result of market value deterioration as the investment is held over time.

In our opinion the industry will have a substantially greater ability to meet the objectives of the Investment Test given greater regulatory guidance for what is a sufficient level of holdings. **As** a start a target should be established as guidance for financial institutions and it may be that it should be tiered based upon the context issue of a banks loan-to-deposit ratio. This would result in a bank coupling investment decisions as a part of overall strategies and performance. **A** bank that does significant lending beyond its deposits held is expected to hold fewer investments than one that has a lower loan-to-deposit ratio. From an economic perspective, any bank that lends more than 100% of its deposits must look at other funding sources for investments. Because of this dynamic it is improbable that a bank will have an equal percentage of investment holdings in comparison to competitors when operating with greater leverage.

In addition, clarity needs to be established as to the amount of credit that a bank receives for investments retained from prior examinations and those introduced for the first time. In our opinion this guidance may need to split Investment Test point garnering capability into two parts, investments-held and investments-traded for CRA purposes. This would invoke the same portfolio management strategies that are utilized from a safety and soundness management. Both would receive some allocation of credit towards the total Investment Test grading while having a lesser negative economic impact from market conditions on investments retained. In addition, this will still maintain the market liquidity incentive for banks to purchase marketable securities and have the flexibility for managing market risk.

An example of how the above concepts may be applied is if a bank operating with a loan-to-deposit ratio of 85% is expected to have one percent of assets in qualified investments. The relation of movement would be inversed with a higher loan-to-deposit ratio resulting in a lower percentage of assets in qualified investments.

In the management of the portfolio of qualified investments for the Investment Test, points would be allocated between an acceptable level of retained investments and new investments. Establishing such guidelines would result in less unintended punitive results from a regulatory perspective and still provides liquidity incentive for the purchase and sale of qualified investments. Of course some minimum standard must be established for the ownership of the trade-pool along with the banks documentation for these activities.

The remaining items in which comment is sought is, the consideration for investments outside of assessment areas promoting a more efficient allocation of community development capital and "innovative versus complex" criterion. Our opinion is that the greater regional economic impact rule is sufficient for governing the applicability of investments outside of the assessment area and should not be changed. In respect to the "innovative versus complex" criterion, implementation of the thoughts noted above will result in a better service to communities with greater circulation of financial resources and thus allow an elimination of this vague criterion.

Conclusion

The periodic review and consideration of CRA is needed to ensure that industry changes does not result in the forsaking of low- and moderate-income people and communities. However, in all considerations of change the goal is to provide incentive for the expansion of fair credit practices and banking services throughout all communities and not to contract the availability of these services because it comes with to extensive a risk. Most notably is the negative effect that most banks will perceive given changes proposed concerning expanded comment and mandatory downgrade. This practice will cause the risk of being creative and formulating complex products that serve many individuals as to risky and catastrophic if an error were to occur.

We also feel that there should be greater guidance established for the Investment Test that allows credit for investments maintained along with establishing a trade-pool criteria. Included as a part of a tiered investment target, we feel that banks will have an opportunity to operate more efficiently and provide greater capital for qualified investments in the market. Collectively the evaluations that take place as a part of a bank CRA Examination will have a more comprehensive basis that will better serve the industry and achieve the goals envisioned for this test component.

I hope that our comments to the proposed rule changes have given you meaningful feedback. If any additional assistance can be provided please contact Edward Owens at (513) 534-6975 or me at (513) 534-1957.

Sincerely]

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